No. 18785

In the

United States Court of Appeals

For the Ninth Circuit

INTERSTATE PLYWOOD SALES CO., a corporation,
Appellant,

vs.

INTERSTATE CONTAINER CORPORATION, a corporation,
Appellee.

APPELLANT'S REPLY BRIEF

Appeal from the United States District Court for the
Northern District of California
Southern Division

HONORABLE W. T. SWEIGERT, Judge

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ARGUMENT

I

The contract called for sales at current market price, which the parties could and did ascertain.

Defendant's argument is based on a false position which is contradicted by the record and the trial court's findings. The trial court emphatically rejected its contention that the five-mill formula was the exclusive means of determining the contract price,[1] that the

1. Defendant seeks to resurrect its argument by repeated references to "the price," and "the contract price" (never the "market price" as stated in the contract) (see Br 4, 5, 11, 19, 51, 55, 64). Counsel also refers to the formula as "the determining objective standard" (Br 11), "the binding objective standard" (Br 66), and "the objective, binding means to fix price" (Br 65).

parties' failure to use it turned the contract into "an agreement to agree" on a "mutually acceptable price," and that the parties only dealt when they could "agree as to price."[2] It found (2 Op, R 102, 110, 119-120) and defendant elsewhere does not deny (Br 12, 19-20) that the parties in fact contracted to deal at the current market price,[3] and that the formula, far from being the exclusive means of determining the price, was only to be used at all when it could not otherwise be determined. The parties, when they failed to use the formula, did not negotiate for a "mutually acceptable price"; they merely acted under the contract to determine the current market price at which they had agreed to deal and which, in view of their position in the market, was the only price at which they could deal at all. Their occasional failure to reach agreement

> "* * * did not arise from bargaining for a new, mutually agreeable price under a new day to day arrangement, i.e., under a new substituted oral contract, but only from an inability of the parties to agree upon what the 'market price' for plywood happened to be at particular times." (2 Op, R 106-107)

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2. See Br 15-19; see also Br 6, 70, 72. Thus, defendant states

> "* * * if they could ultimately agree between themselves as to a price at which defendant would be willing to sell and plaintiff would be willing to buy, an order was placed * * *." (Br 17)

3. The trial court found that market price is legally ascertainable and that a contract to sell at the market price is enforceable (R 83-84).

Furthermore, the record shows conclusively that the parties could and did ascertain that price. Apart from the two periods in which defendant solicited and made extensive outside sales to plaintiff's own customers (May, 1956 through July, 1957 and May, 1959 through December, 1960)[4] plaintiff marketed more than 95% of defendant's production, and during the entire five year life of the contract plaintiff marketed ¾ of defendant's total production (Exh 24; Exh 17, pp 2-4).

Defendant's basic contention is based on a misconception of the evidence and the decision below. It is wholly without merit.

II

The contract was an exclusive distributorship agreement; it was not an option contract.

Defendant asserts that this contract, which provided for the marketing of up to 95% of defendant's production on an exclusive basis, cannot be regarded as a distributorship agreement, because the word "option" in the contract meant that plaintiff was under no duty to buy anything (Br 35, 43-49). The question, in fact, is not whether there was a duty to buy, but whether there was a duty to market defendant's plywood, and of this there is no doubt whatever, for the contract expressly obligated plaintiff to promote and sell defend-

4. Plaintiff marketed more than one-half of defendant's production during each of those periods.

ant's plywood[5] and make large loans to defendant for plant and equipment. It obligated plaintiff to seek orders for plywood which would necessarily result in the exercise of its right to buy, and it therefore disproves by its express terms defendant's theory that it was a mere unilateral option agreement.[6]

Finally, defendant's argument ignores what the parties were trying to do. Defendant was trying to market its plywood through plaintiff; plaintiff was trying to market defendant's plywood. The contract covered 95% of defendant's production and was necessarily an exclusive one.[7] There is no suggestion that plaintiff ever purchased for its own warehousing or use or that plaintiff ever did anything but perform a distributor's function for defendant. It can matter not at all that the

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5. Paragraph 3 provided:

> "SECOND PARTY, so far as possible, agrees to provide the FIRST PARTY with orders for 95% of the output of its veneer or plywood. * * *"

Paragraph 5 provided:

> "SECOND PARTY shall, as near as possible, supply orders to FIRST PARTY to take into account the logs available for veneer and plywood production by FIRST PARTY. * * *" (Op Br 94-95)

See also the recitals to the contract, which set forth its purposes and establish that defendant needed and plaintiff was to provide defendant with marketing services as well as investment capital (Op Br 91-92).

6. Compare the cases cited and relied on by defendant (Br 35, 48-49) for the proposition that an "option," as such, imposes no duty to buy, a principle which has no bearing on the issues in this case: *Transamerica Corp. v. Parrington*, (1953) 115 Cal App 2d 346, 252 P2d 385 at 388-389 (owner of stock subject to option is owner "in his own right" until option exercised); *Ware v. Quigley*, (1917) 176 Cal 694, 169 Pac 377 at 378 (option to sell land is not a "transfer"); *Lawrence Block Co. v. Palston*, (1954) 123 Cal App 2d 300, 266 P2d 856 at 862 (unrestricted discretion to buy created only option contract in absence of mutual obligations); *Kahn v. Lischner*, (1954) 128 Cal App 2d 480, 275 P2d 539 at 542 (qualified acceptance of offer is counteroffer); *Upton v. Travelers' Ins. Co.*, (1919) 179 Cal 727, 178 Pac 851 at 852 (unexercised option to extend insurance policy does not create coverage during option period).

7. The remaining 5% could be sold only locally and not in the general market (Op Br 96).

contract referred to an "option," any more than if it had been in the form of a purchase and sale or consignment or agency agreement.

III

Plaintiff had no material knowledge of defendant's outside sales.

The evidence relied on by counsel to show that plaintiff knew about the outside sales (Br 7, 20, 21) shows only how little it actually knew and the true extent of defendant's duplicity. There was no evidence that plaintiff knew that nearly all of these sales were being solicited and made by defendant to plaintiff's own customers at prices from which defendant deducted part or all of plaintiff's commission. Nor was it shown that plaintiff ever comprehended the great quantity of these sales which were taking place or their relationship to defendant's insistence on prices at the top of the market spread (R 104). The record is undisputed that plaintiff objected to the sales, especially those to its own customers, when they came to its attention (Exhs 18, 19).

Plaintiff does not contend that sales of excess production under paragraph 6 would have breached the contract. It does assert that defendant's intentional and extensive sales program to plaintiff's customers at discount prices, and its insistence on a high price level which created an artificial inventory of unsold production subverted and breached the contract and effectively appropriated the fruits of plaintiff's efforts to defendant. Defendant's conduct was unprincipled and dishonest and constituted a repeated, wilful and flagrant breach of contract.

IV

Defendant's alleged fear of competition by plaintiff is not an issue in the case.

Defendant has misstated the facts concerning the other business activities of plaintiff's officers (Br 21-22, 68, 69, 73). The record shows that until 1959 Mr. Johnson was the president of Grants Pass Plywood Company, a worker owned co-op. Mr. St. Onge, who was plaintiff's sales manager, was also the sales manager of the sales company (Plywood and Veneer Sales Co.) which sold plywood for Grants Pass (1 Tr 31-32, 33). The bulk of the production of Grants Pass was not sheathing plywood (2 Tr 143), and the purchases by Plywood and Veneer Sales Co. from Grants Pass were mostly "other grades" (2 Tr 158). Not only were the products of Grants Pass not competitive with defendant's plywood, but there is no evidence whatever (and defendant suggests none) that any order referred to plaintiff by defendant was ever improperly diverted from defendant to Grants Pass or anyone else[8] (see Exh 31).

8. There is equally no evidence to support the "strong inference" of improper conduct suggested by defendant (Br 69; see also Br 73).

The evidence is also uncontradicted that, commencing no earlier than January, 1961, two months *after* defendant repudiated the contract, plaintiff purchased sheathing plywood from a new mill, Veneer Products, which had commenced production in December, 1960 (2 Tr 148-150, 446-447). Its purchases from Veneer Products continued for six months (2 Tr 153). Defendant thus errs and ignores the record in asserting (Br 22) that in the spring of 1960 Mr. St. Onge commenced to act as the sales manager of Veneer Products. The Veneer Products mill was built in the fall of 1960 (2 Tr 446); it did not commence production until at least December, 1960 (2 Tr 158; see also 2 Tr 150, cited by defendant); and Mr. St. Onge would not be its sales manager in any case, since he acted for sales companies, not mills.

In the complete absence of any contention or evidence that plaintiff did not properly represent defendant or that there was any failure adequately and properly to represent defendant's interests in the market, and considering the volume of defendant's plywood that plaintiff marketed before defendant repudiated the contract, the issue which defendant seeks to raise is a completely false one.

V

The five-mill formula.

1. Contrary to defendant's suggestion (Br 5, 52-53, 73),plaintiff's attorney did not unilaterally put the five-mill formula into the contract. After the draft was dictated, he and defendant's attorney, Mr. Robert H. Schwab (1 Tr 125) who is the father of defendant's president, Mr. William D. Schwab (1 Tr 112, 121, 125), reviewed it and made mutually acceptable changes (2 Tr 40-42). Defendant's president testified that the contract was prepared by both men (1 Tr 127), and its attorney admitted that he had reviewed and approved it (1 Tr 132). There is no factual basis whatever for contending that the contract should be construed against plaintiff, who is not "the party who caused the uncertainty to exist" (Br 52; Cal Civ Code § 1654). We do, however, join with counsel in asserting that this is in material respects an ambiguous and uncertain instrument.

2. Defendant overstates the facts respecting the five named mills (Br 14, 36-37). During the life of the contract, Industrial Plywood published price lists which the parties used (1 Tr 92; 2 Tr 78-79), and United States Plywood Corporation published a price list which was applicable to its mill at Anderson, California and was also used by the parties (1 Tr 90-91, 138, 155; 2 Tr 172-173, 363). Tri-State Plywood also quoted prices to which the parties referred in arriving at the market price (1 Tr 91; 2 Tr 364).

The contract itself contemplated that it might not always be possible to average the jobber prices of all five mills,[9] and the parties' failure to do so scarcely shows either that the formula itself had failed or that the contract was frustrated. That they did not even try to do so resulted from the fact that the formula was not a reliable or sufficient guide to the market price at which they had to deal, and this would have been true no matter how many mills were publishing prices.

3. Counsel wrongly asserts (Br 30) that plaintiff expressed its willingness to retry the whole case, including questions of the validity and enforceability of the contract. The colloquy on which he relies, as even a casual examination of the transcript will disclose (2 Tr 3-5), was directed only to the order and manner of proof, not the issues to be tried. The trial judge gave no hint before the evidence was all in that these issues could or would be expanded beyond those set forth in his order granting a partial new trial.

4. The only "new" evidence received at the partial new trial which is relied on to support the trial judge's second decision is testimony that the five-mill formula applied to fir as well as digger pine plywood (Op Br 25; see Br 30, 61-62).[10] As has been shown (Op Br 81),

9. Paragraph 3 provided:

"* * * It is recognized that the afore-mentioned mills publish price lists at different intervals and vary their prices by granting additional discounts. * * *" (Op Br 94-95)

10. Defendant says:

"The inconsistency between the court's opinion after the first trial and its opinion after the second trial was because of a misapprehension of the court at the first trial as to the products covered by the pricing formula. * * * The effect of such evidence, however, was to render untenable the premise upon which the court had based its decision at the first trial." (Br 71) this evidence did not affect the independent and alternative basis on which the trial court originally sustained the validity and enforceability of the contract, namely, that the five-mill formula was a subsidiary clause which provided only a standard or guide to the current market price (1 Op, R 82-83). That question was and remained beyond the issues which were to be retried.

VI

The price cases relied on by defendant do not support its position.

The price cases cited by defendant (Br 36-43) do not assist it. Not one of them concerned an exclusive distributorship agreement which operated through orders for resale in the open market. They contradict the contention that a formula designed to assist in ascertaining the market price at which the parties agreed to deal is an essential provision of the contract.

In *Canadian Nat. Ry. Co. v. George M. Jones Co.*, (CCA 6 1928) 27 F2d 240 the purchaser contracted to buy coal for its own requirements. The parties were not seeking to sell at the market price, nor was the formula limited to cases in which the market price could not be otherwise determined. Furthermore, the parties later agreed on a fixed price of $3.50, thus expressly modifying the price clause of the contract. The court enforced the modification agreement, and its remarks respecting the discharge of the contract did not control the decision in any event.[11] The case involved only the failure of an agreed price between the parties and has no bearing on the present facts.

In *Turman Oil Co. v. Sapulpa Refining Co.*, (1927) 124 Okl 150, 254 Pac 84 the parties did not intend to operate at the current market price. They agreed that the price would be that paid by a specified company for the same product together with a premium for quality. The other company then changed to a new pricing method based on gravity grades. The parties adopted that method, agreeing that the question whether plaintiff was still entitled to the premium for quality would be reserved for future determination. The action was brought by the seller to recover the premium. The court denied the claim, because the price, after the change in the pricing method, had been determined by an altogether different formula and the formula which had failed was the only means of determining price under the contract.

Ross Lumber Co. v. Hughes Lumber Co., (CCA 5 1920) 264 Fed 757 concerned three contracts for the sale of specific quantities of lumber at a published market price, not an agreement for marketing a mill's

11. The court's remarks are inconsistent with *Mantell v. International Plastic Harmonica Corp.*, (1947) 141 NJ Eq 379, 55 A2d 250, because the contract, as in *Mantell*, called for sales at the same prices charged other persons, and there were no other sales.

production over a long period of time. The court held that wartime price controls frustrated the parties' intent that the price should be regulated by "actual" sales in the market, and that both parties were excused from further performance. Defendant's quotation (Br 41-42) has been torn from context.

> "The idea of a market price is based upon the untrammeled dealing in a commodity, by sellers and buyers unhampered by price fixing by governments or monopolies. There was no such market existing subsequent to June 10, 1918, when the government fixed the maximum price. * * *" (264 Fed at 760)

In this case, there is no suggestion that the market is not free and open, and we know that the market price is ascertainable and was ascertained by the parties for five years.

In *Jules Levy & Bro. v. A. Mautz & Co.*, (1911) 16 Cal App 666, 117 Pac 936 at 937-938 it was specifically found that the parties intended to leave the price to subsequent agreement, and the contract was consequently one to make a contract. The case, consequently, is utterly irrelevant to the present facts. This distinction was recognized in the *California Lettuce Growers* case (*California Lettuce Growers, Inc. v. Union Sugar Company*, (1955) 45 Cal 2d 474, 289 P2d 785 at 790) in which it was pointed out (citing *Levy*) that it is not necessary to the validity of a contract of sale that there be any provision at all for determining the price.

In this case, the parties dealt at the market price, as the trial court found, and the problems presented in *Levy* are simply not involved.

Counsel cites but does not discuss *Louisville Soap Co. v. Taylor*, (CCA 6 1922) 279 Fed 470, in which the parties contracted for rosin at a price based on the daily closing price (not the posted price) on the Savannah Board of Trade. During the period involved, there were no sales of rosin on that market, which had been used by the parties as a reasonably accurate reflection of current market price (at 476-477). The court, in language which supports plaintiff's position in this case, held that in the absence of any transactions in the market, there was no way of determining

> "Prices that would reflect the true condition of the market generally, * * *" (279 Fed at 477).

The posted price was not an adequate guide, because

> "* * * the quotations posted did not reflect the true and actual condition of the market as to price * * *" (279 Fed at 478).

The price provision had failed,

> "* * * because indefinite and uncertain, and *[it was] no longer possible of ascertainment by the*

> *means or method provided in the contract or in any other way*." (279 Fed at 478; emphasis supplied).

See also Prosser, *Open Price Contracts for the Sale of Goods*, 16 Minn Law Rev 733 at 785-787 (1932).

Shell Petroleum Corporation v. Victor Gasoline Co., (CCA 10 1936) 84 F2d 676 at 679-680, cert den (1936) 81 L Ed 450, also cited by defendant (Br 37), stands for the same proposition. That was a contract for gasoline at a minimum price no lower than 2¢ less than the monthly average quotation for a specified grade of gasoline published in a named trade journal. During the period in question, the trade journal ceased to publish prices for that product. The sellers sought to recover under the minimum price clause by proving that a different type of gasoline, for which prices were quoted, was commonly regarded as the same thing. The court rejected the claim, because the products were not in fact the same. It said:

> "* * * it was the intention of the parties to use the market price to be ascertained from monthly average quotations in a trade journal of a different commodity than that purchased, from which the deduction of two cents per gallon should be made. Certainly they did not intend to be bound *by quotations that were carelessly made and not fairly in accord with market prices*. It was not contemplated that those quotations would cease, but would continue for the life of the contract. Neither party was responsible for their cessation, and neither

> should be made to suffer damage on that account, or *forego its rights under the contract if they can be established by competent proof.* The quotations were not intended as mere formalities. *They were to represent market price, and if proof is obtainable as to what the market price of 58-60 U.S. Motor gasoline was during the time in question it must be inferred that the quotations if they had been made would have been in accord.*" (84 F2d at 679-680; emphasis supplied)

Thus, where a pricing standard is used in the belief that it will reflect market price, and that standard fails, other means of determining the market price can be used, and the contract will not fail with the formula unless there is no market or the market price cannot be otherwise ascertained.

Defendant's attempt to distinguish *Mantell v. International Plastic Harmonica Corp.*, supra, (1947) 141 NJ Eq 379, 55 A2d 250 merely emphasizes its application to the present facts. In that case, the failure of a price clause was held not to terminate the contract, because the contract was a distributorship agreement in which "price" was a subordinate matter. The court so held, even though the article involved was a new device and not one in general market competition, such as plywood. Furthermore, the court's reliance on the immediate mutual obligations of the parties is directly applicable to the present facts. Plaintiff in this case was obligated to develop a market for defendant's production and to make large loans to defendant for new equipment. There is no contention that plaintiff did not perform these duties. They were immediate duties, duties which did not depend upon the formula and which disprove defendant's contention that the contract was discharged when it could not be applied on a five-mill basis. It is simply not true that "plaintiff did not wish to assume the obligation to sell for the manufacturer" (see Br 48). It expressly obligated itself to do so in the contract, and this obligation was not impaired or affected by the option language in the contract.

VII

The doctrine of practical construction is applicable to the case.

1. The doctrine of practical construction is applicable to determine the mutual intent of the parties at the time of contracting (see Def Br 50-52). In this case, the parties' conduct confirmed the trial court's finding that their contract called for sales at current market price, and that this was the price which they constantly determined without reference to the formula or whether it could or could not be applied. The parties persisted in this construction of the contract for five years, until defendant concluded that it could market its production directly and perhaps save for itself a point or two of plaintiff's commission.

2. The terms of the contract were highly ambiguous with respect to whether the formula was to be the sole and exclusive means of determining the market price at which the parties agreed to deal. The differences between paragraph 3 (which contained the formula and concerned the price to be charged plaintiff's customers) and paragraph 10 (which concerned the price plaintiff was to pay defendant and made no reference to the formula, but did provide for arbitrating certain prices) were themselves proper subjects of construction by reference to the parties' conduct. These ambiguities are increased by consideration of the circumstances in which the contract was negotiated,[12] which made it highly unlikely that the formula was intended to be more than a guide to market price. The market position of the parties, the immediate and long term obligations which they assumed, and plaintiff's capital risk all combined to create substantial doubt about their intent. This doubt is emphasized by the uncontradicted testimony of both sides that the formula was not to be used at all except where market price could not otherwise be determined.

3. Finally, under controlling California law the ambiguity, insofar as it is necessary to the application of

12. Counsel does not suggest that the circumstances cannot be shown or considered; they can. Cal Code Civ Proc § 1860.

the practical construction doctrine, need not appear on the face of the contract, which can well mean one thing to the court but something different to the parties. The parties' conduct, if ambiguous under the agreement, itself creates the ambiguity, and the doctrine is applicable. The parties' conduct in this case unquestionably required its application. *Crestview Cemetery Association v. Dieden*, (1960) 54 Cal 2d 744, 8 Cal Rptr 427, 356 P2d 171 at 177-178; Op Br 58-65.[13]

VIII

The arbitration clause is inconsistent with defendant's position.

Defendant's contention that the arbitration clause was waived by the commencement of this action wholly misconceives plaintiff's point. The question is not whether plaintiff waived its right to arbitrate by bringing this lawsuit; it is whether the presence of the arbitration clause in the contract does not prove that the formula was merely a guide or barometer to market price and was not intended to be either exclusive or fundamental to the operation of the contract. The question is not whether plaintiff should have resorted to this remedy, but whether the existence of the remedy is not

13. This rule has been repeatedly applied since *Dieden*. See *Beab, Inc. v. First Western Bank (etc.)*, (1962) 204 Cal App 2d 680, 22 Cal Rptr 583 at 588; *Collins v. Home Savings and Loan Association* (1962) 204 Cal App 2d 86, 22 Cal Rptr 817 at 824. In *Dieden*, as here, defendant's contention was an afterthought (356 P2d at 178). As late as the spring of 1960, defendant affirmed its obligations under the contract (Exh 2; R 106).

basically inconsistent with defendant's contention that the contract was discharged by the parties' failure to use the formula. If defendant's present contention had ever been made prior to its repudiation of the contract, the arbitration clause could have been used and would have been binding on the parties.

CONCLUSION

The errors of the trial court resulted from an incorrect analysis of the contract relationship between the parties and resulting mistakes of law and its manifestly wrong conclusion (R 121-122) that obligations of good faith and fair dealing are not present in this, as in all other types of contracts. The trial court's fact findings largely supported plaintiff's position and resolved the issues in the pretrial order in plaintiff's favor. The remaining issues were legal, not factual, and defendant's "record references" in its brief (Br 64-71), which seek in part to sustain its tendered findings which the trial court rejected, are merely erroneous legal contentions. Some of them, indeed, disregard and conflict with the findings in the trial court's second opinion (see, e.g., Spec 9, Br 65; Spec 12, Br 66).

For a substantial period during the life of the contract, plaintiff marketed more than 95% of defendant's production, and even when defendant was engaging in its program of outside sales plaintiff sold more than one half of all that defendant produced (Exh 24; Exh 17, pp 2-4). During the entire life of the contract, plaintiff marketed ¾ of defendant's total production. It is therefore wholly untrue to state (Br 72) that plaintiff

> "* * * assumes that the parties * * * would not have been confronted with the same dead-end of price disagreements that characterized their operations in the past. * * *"

There was no dead end. On the contrary, the contract worked reasonably well, and the market price was ascertainable and was in fact ascertained by the parties for five years. Like most contracts, its effectiveness depended on their integrity and good faith in performing it, but this does not affect its validity or enforceability.

The judgment should be reversed and the case should be remanded for computation and entry of judgment for the amount of plaintiff's damages.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of the foregoing brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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